

**STATE OF NORTH DAKOTA
BISMARCK, NORTH DAKOTA**

**REPORT OF EXAMINATION
OF
SOUTHWEST MUTUAL INSURANCE COMPANY
NEW SALEM, NORTH DAKOTA**

**AS OF
DECEMBER 31, 2001**

STATE OF NORTH DAKOTA
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that
I have compared the annexed copy of the Report of Examination of the

Southwest Mutual Insurance Company

New Salem, North Dakota

as of December 31, 2001, with the original on file in this Department and that the same is a correct
transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto
set my hand and affixed my official
seal at my office in the City of
Bismarck, this _____ day of
_____, 2002.

Jim Poolman
Commissioner of Insurance

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New Salem, North Dakota
August 23, 2002

Honorable Jim Poolman
Commissioner of Insurance
State of North Dakota
600 East Boulevard
Bismarck, ND 58505

Dear Sir:

Pursuant to your instructions and in accordance with the North Dakota Insurance Code and resolutions adopted by the National Association of Insurance Commissioners, an examination was made of the books, records, and financial condition of

Southwest Mutual Insurance Company

New Salem, North Dakota

as of December 31, 2001.

INTRODUCTION

Southwest Mutual Insurance Company, New Salem, North Dakota, hereinafter referred to as the "Company," was last examined as of December 31, 1996, by a representative of the State of North Dakota.

SCOPE OF EXAMINATION

The current examination covers the period January 1, 1997, through December 31, 2001, including any material transactions and events occurring subsequent to the examination date and noted during the course of this examination.

This examination was made in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners with due regard to the statutory requirements of the insurance laws, rules, and regulations of the State of North Dakota.

Examination procedures included a verification and evaluation of assets, a determination of liabilities, and reviews of corporate records, claim files, and other records relating to Company operational practices.

The Company was in compliance with all recommendations contained in the previous examination report.

HISTORY

The Company was incorporated on April 16, 1900, as "The Morton County Mutual Fire and Lightning Insurance Company" and commenced business on July 21, 1900. At a later date, the Company's operating rights were extended to include the County of Oliver and the name was amended to "The Morton and Oliver Counties Mutual Fire and Lightning Insurance Company".

The Company's term of existence is perpetual as provided by N.D. Cent. Code § 26.1-13-03.

Effective January 1, 1997, the Company merged with Adams Farm Mutual Insurance Company located in Hettinger, North Dakota. The two companies formed a new company called Southwest Mutual Insurance Company located at New Salem, North Dakota.

MANAGEMENT AND CONTROL

The Company is controlled by its membership. Any person owning property within the limits of the territory within which the Company is authorized to transact business may become a member of the Company and be entitled to all the rights and privileges accorded each member. No person who does not reside within such territorial limits shall become a director of the Company.

Directors

The management of the Company's affairs, business, and property is vested in a Board of Directors composed of seven members elected for staggered terms of three years each at the annual meeting of the membership. A majority of the entire Board of Directors constitutes a quorum for the transaction of business.

Directors duly elected and serving the Company at December 31, 2001, were as follows:

Name and Residence	Term Expires
Marcus Erhardt New Salem, ND	2004
Cecil Kramer New Salem, ND	2004
Richard Welk Zap, ND	2002
Allen Opp New Salem, ND	2002
Robert Schroeder New Salem, ND	2003
Darrel M. Suchy Mandan, ND	2003
Nelvin Henke Hanover, ND	2003

Officers

Officers are elected annually by the Board of Directors at the first meeting of the Board of Directors held after each annual meeting. Officers serving at December 31, 2001, were as follows:

<u>Name</u>	<u>Office</u>
Cecil Kramer	President
Darrel M. Suchy	Vice President
Allen Opp	Second Vice President
Brenda Doll	Secretary and Treasurer

Audit Committee

During the period under examination, the Board selected two members to serve on an Audit Committee whose duty it is to examine semi-annually the books, records, and accounts and to make a certified report of its findings to the Board of Directors, together with such recommendations as it deems necessary. As of December 31, 2001, this committee was composed of the following:

Marcus Erhardt	Bernice Bauer
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CORPORATE RECORDS

The minutes of the meetings held by the membership and directors during the years under examination were reviewed for compliance with the Articles of Incorporation, Bylaws, and statutory requirements.

There were no amendments to the Bylaws or Articles of Incorporation during the period under review.

Members

During the period under examination the annual meetings of the policyholders were held on the following dates: June 5, 1997; June 4, 1998; June 3, 1999; June 1, 2000; and June 7, 2001.

Directors

During the period under examination, the Board of Directors held 13 regular meetings in 1997, 12 in 1998, 1999, and 2000, and 14 in 2001.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2001, there was in force a policyholder's protection plus bond covering the Company against acts committed by dishonest employees in the amount of \$100,000 subject to a \$5,000 deductible. The coverage meets the minimum amount of fidelity insurance recommended in the NAIC's *Financial Examiners Handbook* which is \$50,000.

The Company also had in force a directors and officers liability insurance policy providing a \$1,000,000 limit of liability each policy year. Each claim is subject to a \$5,000 deductible. The policy provides coverage for errors or omissions in the performance of professional services and wrongful acts of a director or officer while acting solely in their individual or collective capacities as directors and officers.

Insurance coverage on the Company's home office building was reviewed and appeared to be adequate.

TERRITORY AND PLAN OF OPERATION

At December 31, 2001, the Company had 66 licensed agents and was authorized to transact business within the following counties:

Adams	Billings	Burleigh	Bowman	Dunn
Hettinger	Golden Valley	Grant	Kidder	McKenzie
McLean	Mercer	Morton	Mountrail	Oliver
Sioux	Slope	Stark	Williams	

SIGNIFICANT OPERATING RESULTS

Growth

The following exhibit reflects the growth of the Company over a 10-year period. Data with respect to the years 1992 through 1995 and years 1997 through 2000 is compiled from home office copies of the filed Annual Statements. Data for the years 1996 and 2001 reflects the results of examinations. The operational results are presented on a cash basis.

Year	Admitted Assets	Total Liabilities	Surplus as Regards Policyholders	Net Premiums Written	Underwriting Deductions	Investments and Other Income	Net Income (Loss)
1992	\$1,408,860	\$216,821	\$1,192,039	\$306,391	\$169,782	\$ 83,633	\$ 220,242
1993	1,519,105	209,357	1,309,748	321,294	269,485	84,945	136,755
1994	1,439,355	239,218	1,200,137	335,080	471,592	94,394	(42,118)
1995	1,378,775	253,549	1,125,226	357,613	545,559	97,929	(90,018)
1996	1,192,988	238,726	954,263	364,798	650,762	103,194	(182,771)
1997*	1,613,660	744,819	868,841	822,872	944,740	47,632	(74,235)
1998	1,768,607	737,684	1,030,922	1,013,003	967,983	136,167	181,188
1999	1,460,404	734,114	726,289	1,014,893	1,474,306	116,334	(343,079)
2000	1,491,581	857,193	634,387	943,233	987,677	120,935	76,492
2001	1,361,070	855,459	505,610	976,374	1,380,555	131,217	(272,964)

* Merger with Adams Farm Mutual Insurance Company was effective January 1, 1997.

Operating Ratios

The underwriting ratios presented below are on a cash basis and encompass the five-year period ending December 31, 2001:

	2001	2000	1999	1998	1997
Premiums	100%	100%	100%	100%	100%
Deductions:					
Losses and Loss Adjustment	91.3%	55.5%	101.3%	53.4%	63.7%
Underwriting Expense	50.1%	49.2%	44.0%	42.1%	51.2%
Total Deductions	141.4%	104.7%	145.3%	95.5%	114.9%
Net Underwriting Gain (Loss)	(41.4%)	(4.7%)	(45.3%)	4.5%	(14.9%)

MARKET CONDUCT ACTIVITY

Treatment of Policyholders

Claims: From an examination of claim files, the Company appears to pay claims fairly within policy provisions upon receipt of satisfactory proof of loss or damage.

Advertising: The advertising material was reviewed and none appeared to be deceptive.

REINSURANCE

The Company ceded reinsurance under a reinsurance treaty with Grinnell Mutual Reinsurance Company during the years under examination. This nonaffiliated ceding contract consists of individual occurrence of loss and aggregate excess as summarized below. The contract contained all the required clauses including the insolvency clause required by N.D. Cent. Code § 26.1-02-21.

Type: Excess

Reinsurer: Grinnell Mutual Reinsurance Company

Scope: Fire, Lightning and Extended Coverage:

(A) Individual Occurrence of Loss Excess - covers all risks written by the Company in excess of a \$50,000 retention subject to the following limits:

Dwellings	\$750,000
Farm Outbuildings	750,000
Livestock Confinements	500,000
Commercial and Public Property	500,000

(B) Aggregate Excess - provides coverage for 100 percent of the Company's aggregate net loss in excess of a defined retention limit. The retention limit for 2001 was \$688,083.

Premium: (A) Individual Occurrence of Loss Excess - The 2001 annual premium was \$.2896 per \$1,000 of adjusted gross fire risks in force at the end of each month during the contract year.

(B) Aggregate Excess - The 2001 annual premium was \$.715 per \$1,000 of gross fire risks in force at the end of each month during the contract year.

Commissions: None

Termination Date: The agreement may be terminated only as of the last day of any calendar year by either party upon 90 days notice in writing.

ACCOUNTS AND RECORDS

The accounts and records of the Company are on a cash basis and consist of a cash receipts journal, a check register, a claims register, a policy register, and a corporate record book. The Company's computer hardware at December 31, 2001, consisted of four personal computers, three printers, and peripheral equipment. The Company uses the WRC software program for policy processing, cash disbursement, and general ledger transactions.

A trial balance was prepared as of December 31, 2001, for the purpose of tracing it to the Annual Statement. No exceptions were noted.

The following exceptions related to Accounts and Records were noted:

- The total of claims paid in the 2001 claim register did not reconcile with the December 31, 2001 trial balance. **It is recommended that the Company establish procedures to ensure that the claim register contains accurate and complete information.**
- The Company could not locate voided check number 14077 which was issued for \$84,750. **It is recommended that the Company issue a stop pay order for check number 14077. It is also recommended that the Company adopt a policy to insure that all voided checks are properly voided and retained for inspection.**

FINANCIAL STATEMENTS

The following statements reflect the financial condition of the Company as of December 31, 2001, as determined by this examination and its operating results for the year then ended.

Southwest Mutual Insurance Company
Statement of Assets, Liabilities, and Surplus
December 31, 2001

ASSETS

LEDGER ASSETS:

Bonds	\$533,498.49	
Stocks	613,985.91	
Real Estate	57,067.04	
Cash on Hand and Checking Account	(4,210.85)	
Cash on Deposit	150,122.30	
TOTAL LEDGER ASSETS		\$1,350,462.89

NONLEDGER ASSETS:

Interest Due and Accrued on Bonds	\$ 4,084.55	
Interest Due and Accrued on Stocks	2,568.02	
Interest Due and Accrued on Cash on Deposit	3,139.50	
Furniture, Fixtures, and Automobiles	21,230.68	
Premiums in Course of Collection	4,589.29	
Reinsurance Recoverable on Paid Losses	8,820.93	
TOTAL NONLEDGER ASSETS		44,432.97

DEDUCT: ASSETS NOT ADMITTED

Furniture and Fixtures	\$ 21,230.68	
Book Value of Ledger Assets in Excess of Market Value	12,595.01	
TOTAL NONADMITTED ASSETS		33,825.69

TOTAL NET ADMITTED ASSETS	<u><u>\$1,361,070.17</u></u>
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LIABILITIES

Unpaid Losses	\$ 28,454.18	
Unpaid Loss Adjustment Expenses	10,915.77	
Unearned Premium Reserve	567,825.01	
Commissions Due and Payable to Agents	688.39	
Unpaid Taxes	6,594.68	
Unpaid General Expenses	1,265.96	
Borrowed Money and Accrued Interest Thereon	153,455.75	
Reinsurance Premiums Due and Payable	86,260.11	
TOTAL LIABILITIES		\$855,459.85

SURPLUS TO POLICYHOLDERS	<u>505,610.32</u>
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TOTAL LIABILITIES AND SURPLUS	<u><u>\$1,361,070.17</u></u>
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Southwest Mutual Insurance Company
Statement of Cash Receipts and Cash Disbursements
For the Year 2001

INCOME:

Gross Premium Income	\$1,327,799.49	
Less: Return Premiums	31,221.88	
Premiums for Reinsurance Ceded	320,203.46	
	<hr/>	
NET PREMIUM INCOME		\$976,374.15

Interest on Bonds	32,981.55	
Dividends on Stocks	34,440.61	
Gross Rent From Company's Property	2,520.00	
Interest on Cash on Deposit	18,217.93	
Profit on Sale or Maturity of Ledger Assets	(933.88)	
Money Borrowed During Year	150,000.00	
Commissions and Fees Received on Liability Business	43,968.80	
Miscellaneous Income	21.84	
	<hr/>	
TOTAL INCOME RECEIPTS		\$1,257,591.00

DISBURSEMENTS:

Gross Losses Paid and Incurred in 2001	\$ 821,930.40	
Gross Losses Paid in 2001 But Incurred in Prior Years	151,726.37	
Deduct: Subrogation	943.48	
Salvage	4,922.25	
Reinsurance	121,353.35	
	<hr/>	
NET LOSSES PAID		\$ 846,437.69

Claim Adjustment Expenses	44,983.55	
Commissions Paid to Agents	234,101.01	
Directors Fees and Expenses	6,332.03	
Salaries to Employees	120,732.77	
Printing, Stationary, and Office Supplies	16,787.97	
Rent and Rent Items	2,400.00	
Real Estate Expenses	6,301.12	
Taxes on Real Estate	1,069.23	
State and Local Insurance Taxes	22,632.00	
Insurance Department Licenses and Fees	910.00	
Payroll Taxes	20,024.54	
Legal Fees and Auditing	469.46	
Travel and Travel Items	11,870.80	
Advertising	1,298.05	
Dues and Donations	3,581.00	
Equipment	4,241.78	
Insurance and Bonds	7,544.07	
Postage, Telephone, and Bank Charges	13,335.94	
Employee Relations and Welfare	7,462.97	
Data Processing Expenses	2,790.60	
Miscellaneous Expenses	5,249.06	
	<hr/>	
TOTAL FUNDS DISBURSED		1,380,555.64
NET GAIN (LOSS)		<hr/> <u>\$ (122,964.64)</u>

COMMENTS TO THE FINANCIAL STATEMENTS

Financial statement balances at December 31, 2001, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

Bonds

The following schedule presents the classification, market value, actual cost, par value, book value, and admitted value of all bonds owned by the Company as of December 31, 2001:

Classification	Market Value	Actual Cost	Par Value	Book, Admitted, and Investment Value
Agencies of U.S. Government	\$238,393.04	\$235,977.86	\$237,000.00	\$236,498.49
Utilities	30,000.00	30,000.00	30,000.00	30,000.00
Negotiable CDs	167,000.00	167,000.00	167,000.00	167,000.00
Industrials	99,500.00	99,245.00	100,000.00	100,000.00
Totals	<u>\$534,893.04</u>	<u>\$532,222.86</u>	<u>\$534,000.00</u>	<u>\$533,498.49</u>

The Company did not complete the NAIC Designation Column in Part 1 of Section VII of the 2001 Annual Statement. **It is recommended that the Company record the NAIC designation for all bonds owned at year end in the NAIC Designation column in Part 1 of Section VII of the Annual Statement.**

Stocks

The following schedule discloses the classification, number of shares, cost and book value, and market or admitted value of all shares owned at year end:

Classification	Numbers of Shares	Cost and Book Value	Market and Admitted Value
Common Stocks:			
Utilities	974	\$ 17,327.34	\$ 28,242.36
Insurance	60	3,000.00	10,152.60
Mutual Funds:			
Money Market	6,941.21	6,941.21	6,941.21
Bond Funds	73,918.96	526,204.75	506,983.50
Stock Funds	1,726.48	60,512.61	49,071.23
Totals	<u>83,620</u>	<u>\$613,985.91</u>	<u>\$601,390.90</u>

Real Estate

The Company does not record depreciation on capitalized improvements to real estate in the year improvement is capitalized. **It is recommended that the Company record depreciation for capital improvements to real estate in the year those expenditures are capitalized.**

Cash

The list of outstanding checks as of December 31, 2001, included approximately 50 checks over two years old. **It is recommended that the Company report uncashed checks over two years old to the Unclaimed Property Division of the State Land Department in accordance with N.D. Cent. Code Chapter 47-30.**

Premiums in Course of Collection

The Examiner determined premiums in the course of collection to be \$4,589.29 or \$4,826.19 less than the amount of \$9,415.48 reported by the Company in its 2001 Annual Statement. The Examiner determined the admitted value by comparing the December 31, 2001, list of uncollected premiums to the December 31, 2001, in-force premium report. The Examiner non-admitted uncollected premiums not included on the December 31, 2001, in force report which resulted in a \$4,826.19 reduction to premiums in course of collection as reported by the Company.

Unpaid Losses

The reserve for unpaid losses at December 31, 2001, was determined by this examination in the amount of \$28,454.18 or \$3,778.85 more than the \$24,675.33 reserve established by the Company. The Examiner established the reserve for unpaid losses based on a review of subsequent payments and reserves for pending claims.

Unpaid Loss Adjustment Expenses

The Examiner established the foregoing liability using estimated unit claim costs based on costs paid in the preceding year and applied the estimated unit cost to the number of 2001 and prior unpaid claims. The liability established by this examination exceeded the Company's reported liability by \$2,275.77.

Commissions Due and Payable to Agents

Commissions due and payable was determined to be \$688.39 or \$1,349.51 less than the amount reported by the Company in its 2001 Annual Statement. The reduction in this liability is directly related to the examination reduction in the asset caption "Premiums in Course of Collection."

Borrowed Money and Accrued Interest Thereon

The following schedule reflects the items and amounts comprising the liability for borrowed money at December 31, 2001:

Item	Lender	Principal Amount	Date of Loan	Interest Rate	12/31/2001 Accrued Interest
1	Security First Bank of ND	\$ 75,000.00	8/27/2001	8.28%	\$2,173.50
2	Security First Bank of ND	25,000.00	9/5/2001	8.28%	672.75
3	Security First Bank of ND	50,000.00	11/8/2001	8.28%	609.50
Totals		<u>\$150,000.00</u>			<u>\$3,455.75</u>

The liability for accrued interest as determined by this examination is \$8,964.25 less than the amount reported by the Company. The Examiner computed accrued interest to December 31, 2001, rather than over the length of the loan as determined by the Company.

The Board of Directors did not authorize the foregoing loans made with the Security First Bank of ND in 2001 as required by N.D. Cent. Code § 26.1-05-18. **It is recommended that the Board of Directors authorize all loans before the Company enters into the loan transaction.**

Surplus to Policyholders

Surplus to policyholders, as determined by this examination, was in the amount of \$505,610.32, a net decrease of \$567.05 in the amount of \$506,177.37 as reported by the Company in its 2001 Annual Statement.

Adjustments affecting the surplus account are reflected in the following exhibit:

Caption	Company	Examination	Increase or (Decrease)
Non-Ledger Assets:			
Premiums in Course of Collection	\$ 9,415.48	\$ 4,589.29	\$(4,826.19)
Liabilities:			
Unpaid Losses	24,675.33	28,454.18	(3,778.85)
Unpaid Loss Adjustment Expenses	8,640.00	10,915.77	(2,275.77)
Commissions Due and Payable	2,037.90	688.39	1,349.51
Borrowed Money and Accrued Interest	162,420.00	153,455.75	8,964.25
Net Change			<u>\$ (567.05)</u>

CONCLUSION

The financial condition of Southwest Mutual Insurance Company, New Salem, North Dakota, as determined by this examination is summarized as follows:

TOTAL ADMITTED ASSETS		<u>\$1,361,070.17</u>
Liabilities	\$855,459.85	
Surplus to Policyholders	<u>505,610.32</u>	
TOTAL LIABILITIES AND SURPLUS		<u>\$1,361,070.17</u>

During the five-year period under examination, admitted assets increased by \$168,081.83, liabilities increased by \$616,734.35, and surplus to policyholders decreased by \$448,652.52.

The Examiners express their appreciation for the courteous cooperation extended them during the course of this examination.

In addition to the undersigned, Rhoda Sautner, CPA, North Dakota Insurance Department Examiner, assisted in this examination.

Respectfully submitted,

David Weiss, CFE
Examiner
N.D. Insurance Department

COMMENTS AND RECOMMENDATIONS

- Page 6 It is recommended that the Company establish procedures to ensure that the claim register contains accurate and complete information.
- Page 6 It is recommended that the Company issue a stop pay order for check number 14077. It is also recommended that the Company adopt a policy to insure that all voided checks are properly voided and retained for inspection.
- Page 9 It is recommended that the Company record the NAIC designation for all bonds owned at year end in the NAIC Designation column in Part 1 of Section VII of the Annual Statement.
- Page 10 It is recommended that the Company record depreciation for capital improvements in the year those expenditures are capitalized.
- Page 10 It is recommended that the Company report uncashed checks over two years old to the Unclaimed Property Division of the State Land Department in accordance with N.D. Cent. Code Chapter 47-30.
- Page 11 It is recommended that the Board of Directors authorize all loans before the Company enters into the loan transaction.